

**STATE INVESTMENT COMMISSION
MINUTES
SEPTEMBER 26, 2002**

The State Investment Commission (“the Commission”) meeting was called to order by Gordon L. Mullis, proxy for T. Kevin Flanery, Secretary, Finance and Administration Cabinet at 2:00 p.m. on September 26, 2002 in Room 264 of the Capitol Annex. Other members present were Ellen Bale, South Central Bancshares of Kentucky, Inc; Brooke Parker, proxy for Jonathan Miller, Treasurer; and James O. King, Peoples State Bank.

Mr. Mullis confirmed a quorum was present and that the press had been notified of the meeting. At this time, Mr. Mullis introduced Jim King and Ellen Bale who were recently appointed to the Commission. Janet Rivers administered the Oath of Office to the new members.

Mr. Mullis asked for approval of the June 20, 2002 minutes. A motion was made by Mr. King and seconded by Ms. Parker to accept the minutes of the June 20, 2002 meeting. Motion **CARRIED.**

Dwight Price, Portfolio Manager, Office of Financial Management, gave an overview of the Commonwealth's portfolio for the new members. He explained the mission of the investment staff is preservation of capital, liquidity, and return. Mr. Price stated that KRS 42.500 is the governing statute for the Commission. Mr. Price pointed out the administrative regulations governing the Commission could be found at 200 KAR.

Mr. King asked what type of securities the Commission was allowed to invest in. Mr. Price stated that Treasuries and agency securities are invested for seven years or less, corporate A rated or higher five years or less, asset backs triple A rated five years less and, taxable municipal securities. Mr. Price indicated that derivatives, repos, swaps, flex repos, futures are also some of the transactions used by staff.

Mr. King asked if the statutes or regulations defined the types of securities in which the Commonwealth can invest. Mr. Mullis indicated that the statutes define the broad categories and the regulations define the specific maturity and credit quality of the investment options that are used to invest the Commonwealth's funds. Mr. King asked if investing the funds for a short term provides optimal liquidity and reduces interest rate risk. Mr. Price indicated that his assumption was correct.

Mr. Price indicated that monitoring the cash balance of the state is also a function that the investment staff performs through the use of CAMRA. He advised the members that the Commonwealth operates four (4) mutual funds for other state government agencies.

Mr. King asked if there was an internal or external audit of the functions and transaction of the investment section. Mr. Price indicated that the Office of Financial Management has an internal auditor on staff and the Commission is audited as a part of the statewide cash audit by the Auditor of Public Accounts. The Division of Audit and Policy Analysis of the Finance and

Administration Cabinet has also performed an audit of these functions, and Mr. Mullis indicated he would share that report with the Commission members.

Mr. Mullis stated that when the Commonwealth changed the accounting process two years ago, the Office of Financial Management was responsible for interfacing the CAMRA information into the Management Administrative and Reporting Systems ("MARS"). Mr. Mullis continued that when the Finance and Administration Cabinet was in the process of selecting the vendor for the statewide accounting system, it was decided it would not be advantageous to try and reinvent the accounting processes that existed in CAMRA. It was decided at that time that the accounting function would stay with the Office of Financial Management investment staff. Mr. Mullis indicated that staff has developed different systems for documentation and is working with the Cabinet's internal auditor to establish a separation of duties. Mr. King asked if any theft or embezzlement had been uncovered. Mr. Mullis stated that neither the Commission nor its staff has ever been involved in any type illegal activity. Mr. King asked if there were any reason to believe problems of that nature presently existed. Mr. Mullis reiterated that one person cannot process the entire transaction, the Treasury Department has to approve the transfer of funds and the bank has to have a signed document. Ms. Bale asked if there has been any type of recommendations about how duties should be separated so that someone else is in charge of auditing the investments. Mr. Mullis stated that the Finance and Administration Cabinet's internal auditor have made some recommendations regarding how duties should be separated within the office. Mr. Mullis stated there was no indication from either the internal auditors or the Auditor of Public Accounts that the accounting process should be removed from the investment staff.

Mr. Price continued the portfolio review by informing the Commission that staff uses Bloomberg to track the Commonwealth's securities. Mr. Price indicated that BondEdge has also been added to help track the securities. Mr. Mullis stated that Farmers Bank and Capital Trust is the actual custodian of the state's funds, however, State Street Bank in New York serves as a sub-custodian. Mr. Mullis indicated state law requires the Office of Financial Management to have a custodial relationship with a depository bank. Mr. Mullis reiterated that all other banking services are provided through Farmers Bank & Capital Trust Company at the request of the Office of Financial Management or at the request of other agencies as a part of the Commonwealth's General Depository Banking Contract.

Mr. Price introduced the investment staff to the Commission members and gave a brief overview of their duties.

Mr. Price presented the Commission members with the August Monthly Investment Income Report and informed them the report is mailed to members monthly (copy attached to the minutes). He stated that if members had any suggestions to make the report more efficient or would like to see certain information contained in the report, that every effort to provide the information would be made. Mr. King suggested a monthly summary of the portfolio's performance at the beginning of the report would be helpful. Mr. Mullis stated that statutes requires only that a monthly investment report be provided to the members, but does not indicate what the report should include.

Discussion continued on the status of the General Fund. Mr. Mullis stated that \$65 million in personal income was deposited in the General Fund on October 9, 2002. Mr. Mullis stated that the tax amnesty program to date has generated approximately \$5.7 million dollars, which is higher than estimated. Mr. Mullis projected the amnesty program will exceed \$20 million net of expense. The deadline for amnesty is September 30, 2002. However, Mr. Mullis anticipates that funds will be received after that deadline.

Ms. Bale asked who served on the State Investment Commission. Mr. Mullis stated there are five people, three of whom are ex-officio members and two are gubernatorial appointments. Mr. Price stated that the Governor, Treasurer, and Secretary of Finance are ex-officio members and Mr. King and Ms. Bale complete the Commission.

Mr. Mullis reported that the next item on the agenda is change in the administrative regulations. However, he indicated that discussion on the proposed changes would be postponed until the new Commission members had an opportunity to review the regulations.

Mr. Mullis suggested that the members may access the regulations on the Office of Financial Management's web site at <http://ofm.state.ky.us>. Mr. Mullis also indicated that the Commission is required by law to meet at least four times a year.

Mr. Mullis stated that the last item on the agenda is a Resolution of Appreciation for Mr. Orson Oliver, who served two terms on the Commission. A motion was made by Mr. King and seconded by Ms. Bale to approve the Resolution of Appreciation. Motion carried and the Resolution of Appreciation was **ADOPTED**.

Mr. King asked how the chairman of this Commission gets appointed. Mr. Mullis stated that the Governor is the chairman by statute and the Treasurer is vice-chairman. In the Governor's absence the Treasurer serves as chairman and in the Treasurer's absence the Secretary of the Finance and Administration Cabinet serves as chairman. Ms. Bale asked if information relative to the membership of the Commission is available on the web site. Mr. Mullis indicated that it was available for review on the web site.

With no further business before the Commission, the meeting was adjourned.

Respectfully submitted,

Gordon L. Mullis, Secretary
State Investment Commission